Recommendation: SELL **Estimated Fair Value: $22 – $38**

1. Reasons for the Recommendation

This recommendation is based on the many factors that continue to weigh on MetLife's overall performance, which will prevent the firm from growing as rapidly or sustainably as seen historically. MetLife continues to focus on ways to reduce costs and increase returns, but the current economic environment limits the effectiveness of these efforts. As a result, it will be difficult for MetLife to make sufficient progress to see dramatic improvements. This is primarily due to the current interest rates, economic instability, and increasingly restrictive regulatory environment in which they operate.

MetLife is currently trading at an approximate 45% discount from its book value of equity. This discount is believed to be the direct result of reasons discussed below, as well as the fact that the return on equity (ROE) has lagged the cost of equity (COE). Over the past 6 years the ROE has been 9.14%, while COE has been 10.5% to 13.2%. Over the last 12 months the ROE has been approximately 4%. This trend is concerning, and is believed to be directly impacting the stock price. The high end of the price range reflects the estimated value of the firm should efforts to improve the ROE, from its current level, be successful. However, the higher probability scenario is that ROE will remain at or below its current level, which will make the high-end price valuation unattainable.

Further review of historical and peer multiples indicates that MetLife is trading at a lower multiple (price over book) than competitors; however, a majority of US based life insurers are currently trading at varying discounts. These industry discounts could represent both overall economic and regulatory uncertainty in the US market, as well as a lack of clarity on how new regulations could impact the market. A weighted multiple for each business segment indicates that MetLife may be trading near a fair value price currently. However, when compared to MetLife's historical multiples, they are trading below five-year averages in both price over book and price over sales.[1]

The overall insurance market, and specifically life insurance in the US, is a mature and established market with large well-capitalized firms. There is little differentiation in product offerings and competition is based upon reduction of product pricing to attract customers. A mature market such as this could see a reduction in total revenues, which could be detrimental to the long-term profitability of MetLife. Factoring in investment risk further increases the dependence on revenue growth and consistent investment returns, which are not guaranteed.

The performance of MetLife's investment portfolio, which is nearing $500 billion, plays a large role in the profitability and sustainability of the firm. Each insurance or annuity policy exposes MetLife to a future financial obligation. Therefore it is critical that sufficient investment gains be maintained to ensure its ability to meet the required payments. MetLife has begun attempting to reduce its variable annuity sales, presumably due to the increased liability.[2] This action shows the critical nature of investment returns and how they impact MetLife. The primary holdings are investment grade corporate and governments bonds both from the US and select foreign countries. Over the past five years MetLife has had growth in its investment portfolio with a 5.5% return, however last year the total return was 4.8%[3]. This could indicate a potential for financial issues should overall interest rates remain low. MetLife also has additional exposure to certain volatile foreign markets both in their operations and fixed income investments. There is also discussion of additional taxes that could be levied on corporations and investment income which could reduce overall returns. Further, some of MetLife's investments, such as real estate, are less liquid and the overall value of underlying assets is more difficult to determine or

[1] See Data in Appendix C
[2] MetLife 2012 3rd Quarter Earnings call, November 1, 2012
[3] MetLife 2011 10-K

liquidate if necessary. It is essential that MetLife maintain its investment performance moving forward to remain competitive.

The insurance industry is also facing the potential for increased scrutiny and regulation of firms, similar to the rules put in place for large commercial banks. MetLife is currently regulated by the US Federal Reserve as a bank holding company because it owns and operates MetLife Bank. MetLife is in the process of selling these banking assets to General Electric (GE) retail bank. Currently the sale is pending approval of the US Office of the Comptroller of Currency (OCC). Upon completion of the sale MetLife intends to deregister as a bank holding company to reduce the government regulatory oversight of their operation. However, as a result of the Dodd-Frank act there is a high probability that MetLife will be labeled as a Systemically Important Financial Institution (SIFI). Prudential Financial, a key competitor to MetLife, recently moved closer to being labeled as a SIFI by the US Government[4]. The SIFI designation would result in increased regulation of MetLife by both state boards as well as the Federal Reserve. State government insurance regulators have also increased efforts to raise capital requirements on large institutions such as MetLife to protect against financial collapse[5]. As a result there is guarantee of increased scrutiny of MetLife that will, at minimum, result in increased reserve ratios, which will hamper MetLife's flexibility.

MetLife's average life insurance loss ratio over the prior three years is 87.5%[6]. There is some fluctuation in the data on a quarter by quarter basis, but primarily MetLife is falling into an acceptable range. However, the auto and homeowners segment has a combined average loss ratio of 96.7%[7] during the same three year period. This is concerning due to the fact that the average is close to 100%, which indicates that there is little margin for error and high potential of liabilities exceeding income should a major catastrophic loss incident occur. This data does not include the recent hurricane (Sandy) that directly impacted New York, Massachusetts and Connecticut, each of which are in the top 5 in auto and homeowner's revenue for MetLife[8]. There is the potential for significant increases in property loss ratios as a result, however these details will not be fully known till the end of the 4th quarter of 2012. In comparison Hurricane Katrina in 2005 cost MetLife around $130 million in resulting claims[9].

MetLife has made positive improvements, which support their ability to increase the firm value moving forward. MetLife remains a dominant force in the life insurance market and is the overall market leader in the US market. They are well established and have had consistent performance for a number of years. MetLife was able to successfully weather the recent financial crisis, and has consistently shown revenue and net income growth. MetLife has also been able to reduce the percentage of total revenue that US sales represent. This was accomplished by growing their international operations via substantial investments in established and emerging markets. The recent acquisition of ALICO in Japan provided a significant boost to international revenue and helped to reduce the overall dependence on the US. MetLife is increasingly a major competitor in the international market and is carefully selecting regions and countries on which to focus. They are a market leader in Mexico and Korea, and have increased sales in both Asia and the Latin American region. There has also been segment specific revenue increases in areas, such as the corporate benefits segment, which saw growth based on an increased focus on the UK. MetLife has also announced intentions to begin operating MetLife Investment Management, which will primarily target institutions,

[4] Scism, Leslie & Zibel, Alan. "Prudential Heads toward 'Systemically Important' Tag". *The Wall Street Journal*, October 19, 2012
[5] Tracer, Zachary. "U.S. Insurance Regulators Tighten Capital Rule on Mortgage Bonds". Bloomberg, October 26, 2012
[6] MetLife earnings conference calls (Prior 3 Years)
[7] MetLife earnings conference calls (Prior 3 Years)
[8] MetLife 2011 10-K
[9] Barr, Alistair. "MetLife, Jefferson-Pilot top estimates", *The Wall Street Journal*, October 27, 2005

insurance companies and public/private pension funds as customers[10] to drive growth of additional sources of revenue.

2. Company Analysis

MetLife is a leading life insurance provider and has a large global footprint, with operations in over 50 countries serving 90 million customers. MetLife controls a large portion of market share in both the US, as well as Mexico, and is growing force in both Japan and Korea. MetLife has also indicated they plan to continue focusing on expansion into a number of developing international markets in the future.

The company has a mix of insurance products that they divide among six segments. These segments are: Life Insurance, Retirement, Corporate Benefits, Auto & Homeowners, and International. The final segment is Corporate & Other, which is comprised primarily of holdings associated with MetLife Bank.

MetLife’s key strengths are related to its brand name and recognition as a market leader in a number of major markets such as the US and Japan. The aging populations of both these nations should drive future demand for life insurance and annuity products for the near term and should provide for some near term stability. Additionally, due to the wide variety of financial products offered, they are able to attract and retain clients thereby increasing revenues. MetLife should be able to continue to utilize their recognizable brand to increase the firm’s value in the future.

MetLife’s weaknesses relate to a current overdependence on the US market for a majority of yearly revenue. This exposes MetLife to financial difficulties if customers allow polices to lapse during periods of economic difficulty. There is also little product differentiation within the insurance market so it is difficult to attract customers who currently have policies, unless moving to MetLife provides a cost benefit or increased coverage in comparison to competitors.

MetLife is in the process of addressing concerns via acquisitions in a number of international markets. The purchase of ALICO, which increased the 2011 international revenue by 176%[11] over the prior year, clearly indicates the importance placed on diversification. MetLife also has the opportunity to grow and expand further in certain other international markets with lower overall saturation. These expansion activities are aimed at increasing both overall firm revenue, as well as establishing stable revenue streams in multiple regions, so that economic difficulties in one area does not have as profound of an effect.

The primary threats to MetLife are due to its large size and product offerings. The majority of products are discretionary in nature and therefore in periods of decreased economic growth MetLife could see reduced revenue. As MetLife continues to expand worldwide they are exposed to increased risks both from worldwide economic downturns as well as region specific loss issues or increased loss ratios due to catastrophic loss of life incidents. MetLife is also faced with a worldwide low interest rate environment, which puts additional pressure on their investment performance as these returns are used to meet obligations to customers. Further risks include increased regulation of the insurance industry both, in the US and abroad, which could at minimum, require the increase of strategic reserves, and at worst, could create an environment that makes effective operations difficult or impossible.

3. Industry Analysis

MetLife’s insurance and financial products are divided among six distinct segments. These are Life Insurance, Retirement, Corporate Benefits, Auto & Homeowners, International, and Corporate & Other, which primarily represents the current holdings of MetLife Bank.

[10] Holm, Eric and Scism, Leslie. “MetLife to Launch Asset-Management Business” October 9, 2012, *The Wall Street Journal*.
[11] MetLife 2011 10-K

Life Insurance

MetLife is one of the largest US firms in the life insurance segment based on premiums. Other major competitors in order of premium revenue are Northwestern Mutual, Mass Mutual, New York Life, and Prudential Financial. MetLife reported $26.27 billion in 2011 revenue for their life insurance segment.[12] Life insurance product sales account for almost 70% of MetLife's overall revenue each year. The market in the US is quite competitive due to the fact that there is a high degree of market saturation, with many potential customers already possessing life insurance and low turnover ratios. These factors are coupled with extreme capital requirements, which limit the ability of new companies to enter the market. The regulatory environment for US insurance providers also limits competition, as it is difficult for new firms to meet requirements for operation.

The life insurance market remains profitable in the US, but has decreased recently due to economic issues. 2011 saw a rebound as far as profit margins, but additional recovery is necessary to get back to pre-recession levels. The S&P industry study determined that year on year growth rate of revenues for 2010 was around 7.1%[13]. Current estimates indicate a 3.4% growth in revenue over the next five years[14].

The decrease in overall revenue in the life insurance sector is primarily due to economic difficulties, which have put pressure on both individuals and insurers. Individuals have scaled back spending due to decreased income, and insures have suffered investment losses. Both these factors have contributed to an overall decrease in the operating revenue of firms in this segment. Assuming an improvement in the overall US economy and a reduction in the unemployment rate, there should be an increase in revenue and income over the next 3-5 years due to several factors. These include: the average age of the US population increasing, the assumed decrease in the unemployment rate, resulting in an increase in available income. These factors would allow more individuals to purchase life insurance policies to protect their dependents. Additional risks in this sector are presented by low interest rates and increased government regulation. Since insurance providers utilize investments income to offset insurance claim liabilities they are exposed to risk if interest rates remain depressed. As a result, if rates remain low certain firms could risk financial collapse. Government regulation regarding capital requirement could pressure insurers into riskier investments or derivative trading in an attempt to meet necessary investment returns. This could put firms at financial risk and undermine the purpose behind the additional regulation.

Retirement

The retirement and pension/annuities sector is quite large in the US. This is due to the fact that both public companies and private retirement and pension programs are included in the overall market. The primary products sold by MetLife in this category are fixed or variable annuities, and overall annuity sales revenue in the US increased by 8% in 2011[15]. The largest organizations in this segment are Fidelity Investments, TIAA CREF, ING Groep, and the Vanguard Group. Resulting competition in this sector is high and most of the competitors are well established. As of 2010, MetLife ranked #16 in total investment assets under management.[16] Additionally, there are many regulatory restrictions placed on a firm that limit the ability of startup companies to easily acquire the capital and approval to operate.

This segment is profitable at the current time, though there is concern moving forward due to the state of the US economy and the ability of plans, specifically pension and annuity plans, to meet required payments with an increasingly aging US population. These additional demands could decrease the overall profitability of this sector in the next 3-5 years until the economic situation improves.

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[12] MetLife 2011 10-K
[13] McMillan, Robert, "S&P Industry Surveys – Insurance: Life & Health, April 12,2012, Pg. 12
[14] Snyder, Sophia. "Life Insurance & Annuities in the US" – IBIS World Industry Report, September 2012, Pg. 3
[15] McMillan, Robert, "S&P Industry Surveys – Insurance: Life & Health, April 12,2012, Pg. 4
[16] Leon, Ken, "S&P Industry Surveys – Investment Services, May 17,2012, Pg. 25

Demand measured by total dollars being invested in retirement plans has been decreasing in the past few years. There has also been a reduction in revenue in the annuities sector, resulting from an increase in the US unemployment rate, decrease in household income available for investment, as well as investment losses suffered by firms who offer annuity products. These factors have combined to decrease the overall revenue and operating income of firms in the annuities and retirement sector. As the US economy improves it is assumed that demand for annuities will increase due to the aging US population who are searching for secure and guaranteed income during retirement. These factors should benefit firms operating in the retirement and annuities segment. Additional risks relate to the current low interest rates, which will remain until approximately mid-2015. This indicates that low risk return from fixed income investments will be reduced. This will put additional pressure on annuity providers who utilize investment income to meet guaranteed returns on certain annuity products. If interest rates remain depressed and firms suffer additional investment losses, certain firms could risk financial collapse if they cannot come up with additional income to meet required payments to customers.

Corporate Benefits

MetLife's operations in this sector are primarily structured settlements and pension closeouts. Both directly relate to their variable and fixed annuity products which are also sold via the retirement and annuity segment. Competition in this sector is limited, but the major companies include: John Hancock, Mass Mutual, New York Life, and Prudential Financial. This segment continues to be profitable for MetLife, though it is unclear how this compares to MetLife's peers, as the products are often a subgroup or portion of many companies' life insurance or annuities sales.

Overall demand for this product line is expected to decrease in the future as more firms have discontinued this form of benefit for their employees. More employers are moving towards defined contribution funds instead of set pensions as a way to provide for their employees retirement, thus removing the liability of large pension funds from their balance sheets. As a result, it is expected that there is a limited life of this segment, and companies will have to move towards other corporate benefits to remain profitable. Low interest rates will place pressure on firms with pension plans and companies that offer closeout or annuity products to cover firm's pension plans moving forward in the near term.

Auto and Homeowners

The overall size of the property insurance market, including both homeowner and auto insurance, is quite large. There are many well established firms that focus primarily on these lines of insurance for their revenue. These firms include All State Corporation**,** State Farm, and Liberty Mutual. The competition level in this sector is also high, as these are large firms that are well capitalized and able to withstand the entrance of new companies into the market. Additionally, the overall product mix is relatively unchanged and there is little room for new products; as the customers primary concern is liability and coverage for repair. The sector also faces a large degree of regulation in the US limiting new entrants. The auto and homeowners industry is currently struggling and not expected to see reasonable growth until approximately 2014[17]. However, this does not reflect the performance of individual firms, but the industry as a whole.

Demand will remain flat as home and auto sales are slower than in prior years, but overall demand should remain stable. If the economy was to improve, and additional home and auto purchases were made, there might be an increase in premium revenue. Risk factors to this sector are lower as there is fairly consistent demand for housing and transportation, and both require insurance policies to protect the assets. Therefore even during economic downturns there is still demand for the products and services provided in this segment.

[17] Kelly, Doug. "Property, Casualty and Direct Insurance in the US" – IBIS World Industry Report, July 2012, Pg. 5

International

Within the international insurance market, MetLife is considerably smaller than some of its competitors. In many ways the international market is quite segmented, and there are very few major companies that have substantial market share worldwide. The primary competition in the international segment is from large firms with extensive assets and market capitalization. These firms are Allianz SE, AXA, Aviva, Prudential Financial, and ING Groep NV. MetLife has focused its efforts on increasing its worldwide market share due to their high dependence on US revenue.

The worldwide and regional competition for MetLife is much higher in the international arena, but it does vary by region. In certain regions MetLife has extremely low market share, while in others, such as Mexico, they are the market leader. This shows the variability of conditions and highlights that regional competition might be with much smaller firms who hold a majority market share in the region.

This sector is primarily a growth sector for MetLife and its competitors, as many firms are targeting emerging or developing nations for sales of their products and attempting to tap previously underserved markets. Profitability is relative and varies from country to country. In some instances firms are "investing" in the future profit by establishing a name and customer base in a country or region that may not currently be profitable. International insurance is viewed by many firms, such as MetLife, as a way to grow existing income and diversify risk away from a single country. The primary customers in the international sector are individuals who either purchase products directly, or through group plans with their current employer.

Revenue in the international insurance sector is expected to see major growth in the coming years. A number of developing nations are expected to increase the size of their "middle class" which would result in more individuals contemplating necessary insurance protections, as well as retirement products. This places firms in a position to see explosive growth in certain developing regions if they have the established base to capitalize on it. Potential risks faced by international insurers are similar to US based insurers, who are facing increased financial pressure due to the economic downturn including low interest rates, high unemployment rates, capitalization requirements, and guaranteed returns on certain product lines. Further risks in developing nations include unsustainable growth and the potential decrease in demand for products in the face of financial difficulties.

Corporate & Other

MetLife's operations in this segment are primarily composed of their current assets from MetLife Bank, a commercial bank and deposit taking institution. MetLife is not attempting to expand in this segment. This is due to the increased scrutiny and regulation that results from being categorized as a bank holding company. Therefore, the assets of MetLife Bank and mortgage issuance operations should be viewed only as assets to be sold. MetLife is currently in the processes of selling the bank deposit assets to General Electric (GE) Capital Retail Bank[18], and has discontinued and sold a portion of its mortgage operations. Upon completion of the sale of the banking assets MetLife intends to deregister as a bank holding company.

[18] Holm, Eric; Scism, Leslie & Linebaugh, Kate "GE, MetLife Seek Okay From New Regulator On Bank Sale" The Wall Street Journal, September 21, 2012

Appendix A: Inputs into the Residual Income Valuation

Betas	
Yahoo Finance Beta	1.92
Bloomberg Beta	1.52
Cost of Equity (Yahoo Beta)	13.17%
Cost of Equity (Bloomberg)	10.45%
Return on Equity (10 Yr. Average)	10.30%
Return on Equity (5 Yr. Average)	9.17%
Return on Equity (2011)	11.67%
Return On Equity (TTM)	4.09%
Dividend Payout Ratios	
MetLife - 5 Yr Average	16.11%
MetLife - TTM	30.80%
Industry Average	29.39%
Book Value of Equity Per Share	$60.27

**Sources: MetLife 10-K, Bloomberg, & Yahoo! Finance*

Appendix B: Inputs into valuation using multiples

Comparable Firms

Life Insurance

	Price/Sales
AIG	**0.91**
Aflac	**0.97**
Prudential	**0.51**
The Hartford	**0.43**
Principal Financial Group	**0.98**
Lincoln Financial	**0.64**
Travelers Insurance	1.09
All State	0.6
UNUM Group	0.55

Retirement

	Price/Sales
AIG	**0.91**

Aflac	0.97
Prudential	**0.51**
The Hartford	**0.43**
Principal Financial Group	**0.98**
Lincoln Financial	**0.64**
Travelers Insurance	1.09
All State	0.6
UNUM Group	0.55

Corporate Benefits

	Price/Sales
AIG	0.91
Aflac	**0.97**
Prudential	0.51
The Hartford	**0.43**
Principal Financial Group	**0.98**
Lincoln Financial	**0.64**
Travelers Insurance	1.09
All State	0.6
UNUM Group	0.55

Auto/Home

	Price/Sales
AIG	0.91
Aflac	0.97
Prudential	0.51
The Hartford	**0.43**
Principal Financial Group	0.98
Lincoln Financial	0.64
Travelers Insurance	**1.09**
All State	**0.6**
UNUM Group	0.55

International

	Price/Sales
AIG	**0.91**
Aflac	0.97
Prudential	**0.51**
The Hartford	**0.43**
Principal Financial Group	**0.98**
Lincoln Financial	**0.64**

Travelers Insurance	1.09
All State	0.6
UNUM Group	0.55

Corporate/Other

	Price/Sales
JP Morgan Chase	**1.79**
Wells Fargo	2.32
Citi	1.84
Bank of America	1.25
US Bancorp	**3.46**

**Source: Yahoo! Finance &MetLife 10-K (2011)*

Appendix C: Historical Multiples

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM
P/B	1.1	1.2	1.3	1.3	1.3	1.3	1.2	0.9	0.9	0.6	0.6
P/S	0.6	0.7	0.8	0.8	0.9	0.9	0.5	0.7	0.7	0.5	0.5
P/E	17.3	13.2	11.3	11.8	15.3	11.3	7.7	-12	14.9	5	13.5

**Source: Morningstar, Inc.*